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Constraining Social Security Cost-of-Living Adjustments

BACKGROUND AND ISSUES

A REPORT

PREPARED BY THE

CONGRESSIONAL RESEARCH SERVICE

FOR THE

COMMITTEE ON THE BUDGET
UNITED STATES SENATE

JANUARY 1985

Printed for the use of the Committee on the Budget

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UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC, December 4, 1984.

Mr. GILBERT GUDE,
Congressional Research Service,
Library of Congress, LM 203
Washington, DC.

DEAR MR. GUDE: A major challenge facing the Congress is to devise appropriate fiscal policies for the social security program in both the short- and long-term. Social security is the Nation's largest and most important domestic program, touching the lives of nearly all Americans. In fiscal year 1985 the program will provide $189 billion in benefits to nearly 36 million retirees, disabled workers, and their dependents and survivors.

Although the Social Security Amendments of 1983 placed the system on solid financial ground well into the next century, the dramatic increase in the Federal deficit has focused attention once again on this huge program. Just last summer, for example, several Senators offered budget reduction plans which would have slowed the growth in the social security program. It is likely that other proposals will be made during debate on the budget this year in light of continuing high Federal deficits. This Committee, while it may not favor such proposals, must be prepared to consider them.

In preparing for the fiscal year 1986 budget, the Committee requests that the Congressional Research Service (CRS) conduct a study of social security and the Federal deficit. The study should focus on options which have been suggested over the past year to reduce the Federal deficit and make social security more financially secure in the future. In particular, the CRS should analyze constraining the automatic cost-of-living adjustments. The study should provide background information, discuss issues associated with each option, and provide illustrative proposals.

To be of greatest use the Committee needs the report by the end of January 1985, in time for congressional action on the fiscal year 1986 budget. Michael Carozza (224–0564) of the Budget Committee staff will be available to consult with CRS throughout the project.

Thank you.

Sincerely,

PETE V. DOMENICI,
Chairman.

LETTER OF SUBMITTAL

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

January 18, 1985

Honorable Pete V. Domenici
Chairman, Committee on the Budget
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Your letter of December 4, 1984 asked the Congressional Research Service (CRS) to conduct a study of measures to reduce expenditures for automatic cost-of-living adjustments (COLAs) provided under the social security program in conjunction with Congressional efforts to reduce projected Federal budget deficits.

In response to your request, I am pleased to submit this report, "Constraining the Social Security Cost-of-Living Adjustment: Background and Issues." The report was prepared by David Koitz, who is a specialist in social legislation in the Education and Public Welfare Division of CRS.

We hope this report, which describes a broad set of proposals and discusses the issues surrounding possible constraint of the social security COLA, will assist your Committee and the Congress generally in arriving at the difficult decisions regarding the Federal budget.

Sincerely,

Gilbert Gude
Director

LETTER OF TRANSMITTAL

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United States Senate

COMMITTEE ON THE BUDGET
WASHINGTON, D.C. 20510

MEMORANDUM

TO: SENATE BUDGET COMMITTEE MEMBERS

DATE: JANUARY 31, 1985

SUBJECT: REPORT ON "CONSTRAINING SOCIAL SECURITY COST-OF-LIVING ADJUSTMENTS"

A major challenge facing the Congress is to devise appropriate fiscal policies for the social security program. Social security is the nation's largest and most important domestic program, touching the lives of nearly all Americans. In fiscal year 1986 the program will provide over $200 billion in benefits to more than 36 million retirees, disabled workers, and their dependents and survivors.

Although the Social Security Amendments of 1983 placed the system on solid financial ground well into the next century, the dramatic increase in the federal deficit has focused attention once again on this huge program. Just last summer, for example, several Senators offered budget reduction plans which would have slowed the growth in the social security cost-of-living adjustments (COLAs). Other proposals may be made during debate on the budget this year in light of continuing high federal deficits. Congress, while it may not favor such proposals, must be prepared to consider them.

I therefore asked the Congressional Research Service of the Library of Congress to provide a comprehensive discussion of social security COLAs and to focus on options which have been suggested over the past several years to reduce the federal deficit and make social security more financially secure.

I believe that the report which has now been completed will be of considerable help to the Senate Budget Committee, as well as to other Congressional committees and individual members, as America considers ways to reduce the federal deficit and ensure the continued financial stability of social security.

Issuance of this report as a Budget Committee print does not, of course, in any way imply that the Committee endorses the conclusions stated or the information presented.

Pete V. Domenici
Chairman

CONTENTS

	Page
Committee letter requesting CRS to conduct this study	III
Letters of submittal	V
Letter of transmittal	VII
Sections:	
I. Introduction	1
II. Present law	2
III. Illustrative proposals	6
Across-the-board reductions in the COLA	6
—Provide less than a full COLA	6
—Freeze the COLA or provide it less frequently	6
—Shorten the CPI measuring period	7
COLA constraints targeted away from low-income recipients	8
—Means-test the COLA	8
—Tax the COLA	9
—Pay full COLAs only up to a certain benefit level	9
Other targeted COLA constraints	10
—Constrain the COLA for early retirees	10
—Constrain the COLA for auxiliaries	10
—Constrain the COLA for families with high replacement rates	10
Stronger "stabilizer" or "fail-safe" measures	11
IV. Issues with reducing the COLA	12
Arguments for reducing the COLA	12
Arguments for retaining the present COLA provisions	15
Peripheral issues with reducing the COLA	17
Appendix:	
Historical development of the social security cost-of-living adjustment	23

42-157 O - 85 - 2

I. Introduction

The social security cash benefits program of Old Age, Survivors and Disability Insurance (OASDI) comprises a major component of the Federal budget. In fiscal year 1984 tax revenues received by the Government for OASDI purposes were $167 billion and represented 25 percent of all Federal revenues. Spending for the program was $178 billion and represented 21 percent of total Federal spending. Because it is so financially significant, the program frequently is brought up in discussions of how to reduce the looming Federal budget deficits and control the growth of entitlement programs. Among its many benefit provisions, the automatic increase in benefits—the so-called cost-of-living adjustment or COLA—is the feature that probably is most often mentioned as a possible candidate for constraint. For almost two decades outlay increases arising from social security benefit increases have been the largest single component of the program's growth and generally have been substantially greater than the combined outlay increases caused by the automatic benefit escalators of all other Federal benefit programs.

However, social security is financed heavily with its own source of revenues: the payroll tax. The fact that it is largely self-financed poses the question of whether it should be brought up in discussions of how to resolve overall budgetary problems, especially if its internal financing appears to be sufficient. In addition, its magnitude also signifies its importance as a source of income to 36.5 million people, as reflected by the fact that it provided 39 percent of the total income of people 65 and older in 1982.[1] Limiting the benefit increase could have significant effects on the economic well-being of many of the program's recipients.

Over the history of the OASDI program, there have been 20 across-the-board benefit increases. Ten of them resulted from the automatic increase provision authorized originally in 1972 and modified 5 times since then. The first automatic increase of 8 percent was provided in July 1975 with subsequent increases having ranged from a low of 3.5 percent in both January 1984 and January 1985 to a high of 14.3 percent in July 1980.

This report, prepared at the request of the Chairman of the Committee, describes how the social security COLAs are determined, illustrates a number of proposals to reduce their cost, and discusses the merits and drawbacks of such modifications. A detailed history of the automatic provisions also is provided in the appendix.

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[1] Income of the Population 55 and Over, 1982. Social Security Administration Office of Research, Statistics and International Policy. Washington: Government Printing Office. March 1984.

II. Present Law

Present law requires that social security benefits be increased automatically whenever the cost of living rises by 3 percent or more. The index used to measure the rise is the Bureau of Labor Statistics' Consumer Price Index for Urban Wage Earners and Clerical Workers (the so-called CPI-W).[2]

Under the measurement procedure provided in the law, the average CPI in the third quarter of the calendar year in which the most recent automatic benefit increase occurred is compared to the average CPI in the third quarter of the next calendar year. If this shows that the CPI has risen by 3 percent or more between these quarters, a benefit increase equal to the actual change in the CPI (rounded to the nearest tenth of a percent) is triggered automatically for the following December, payable in the checks of the following January.

If the rise is less than 3 percent, the law does not provide for a benefit increase that year, but the measuring period would be extended until the third quarter of the next year. The rise in the CPI over this 2-year period would be measured, and if it were 3 percent or more, a benefit increase would be triggered equal to the total rise in the CPI over that 2-year period. It would be reflected in a benefit increase paid the following January. If the CPI still had not risen by 3 percent, in theory this procedure would be repeated again and again until the 3 percent trigger point were reached. In actual practice, the 3 percent trigger has been reached annually since automatic benefit increases first became payable in 1975.[3]

The law also precludes an automatic benefit increase from being triggered whenever an ad-hoc or general benefit increase is enacted by Congress or becomes effective in the year before the automatic increase would become effective.

The law does not require a reduction in benefits if the CPI happens to decline during a measuring period.

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[2] The Social Security Act does not explicitly prescribe that the CPI-W be used. Its use in lieu of the broader based CPI-U stems largely from the fact that it was the only CPI measurement in existence when the automatic benefit increase provision was enacted in 1972. The CPI-U was first issued by BLS in 1978.

[3] Reacting to the possibility that the CPI might not rise by 3 percent between the third quarter of 1983 and the third quarter of 1984—thereby raising the possibility that a benefit increase would not have been triggered for December 1984—Congress passed Public Law 98-604 in October 1984 which effectively discarded the 3-percent trigger for purposes of the December 1984 increase. However, as it turned out the CPI actually exceeded the 3-percent trigger level and resulted in a benefit increase of 3.5 percent.

—*Illustrative calculation of the benefit increase:* The average CPI for each of the calendar quarters used in the calculation of the benefit increase is the straight arithmetical average of the CPIs reported monthly during the quarters. The following example illustrates how the calculation is done using the computation made to determine the benefit increase that was reflected in January 1985 checks.

1. The CPI for the third quarter of 1983 was 299.5. This was the arithmetical average of the CPI for July, August, and September 1983.

Month in 1983	CPI
July	298.2
August	299.5
September	300.8
Total	898.5

The average CPI for the third quarter of 1983 was thus:

$$\frac{898.5}{3} = 299.5$$

2. The CPI for the third quarter of 1984 was 310.0. This was the arithmetical average of the CPI for July, August, and September 1984.

Month in 1984	CPI
July	307.5
August	310.3
September	312.1
Total	929.9

The average CPI for the third quarter of 1984 was thus:

$$\frac{929.9}{3} = 310.0$$

3. The percentage increase in the CPI from the third quarter of 1983 to the third quarter of 1984 was:

$$\frac{310.0 - 299.5}{299.5} \times 100 = 3.5 \text{ percent}$$

This calculation resulted in a 3.5-percent benefit increase effective for December 1984, which was payable in the benefit checks received on January 3, 1985. It applied to all types of recipients,

including persons eligible in December 1984 but not receiving benefits then.

—*The "stabilizer" provision:* The law also contains a contingency provision, called the stabilizer, requiring that if the reserve of Federal securities in the trust funds (excluding the medicare funds) should fall below certain levels, a subsequent benefit increase could be reduced. If the reserve in any of the years 1985–88 were estimated, by the previous July, to fall below a level equal to 15 percent of the coming year's expenditures, the next benefit increase would be limited to the rise in average earnings if lower than the rise in the CPI. In 1989 and later years, the trigger level would be 20 percent. The provision permits a later "catch up" increase to be given to those affected by an earlier constraint caused by the stabilizer, if and when the reserve in the trust funds rose to a level equal to 32 percent of annual expenditures.

—*Other aspects of the program affected by a benefit increase:* Whenever there is an automatic benefit increase, other aspects of the social security program also are changed automatically:

1. The social security taxable earnings base is raised. (The earnings base is the maximum amount of earnings each year that is subject to the social security tax and creditable for figuring social security benefits.) In contrast to the benefit increase, which represents the rise in the cost of living, the increase in the earnings base represents the rise in average earnings in the economy. Generally, this increase represents the rise in average earnings from the third to the second year before the increase becomes effective. For instance, the rise in the earnings base this year—from $37,800 in 1984 to $39,600 in 1985—was based on the 4.9 percent increase in average earnings between 1982 and 1983. The rise in the earnings base is always rounded to the nearest multiple of $300.

2. The amount of earnings that are exempted each year from the social security "earnings or retirement test" is raised. (Benefits are reduced for persons under age 70, if earnings exceed certain exempt amounts.) This automatic increase also is pegged to the rise in average earnings, based on the same calculation used to compute the automatic increase in the taxable earnings base. The increase is rounded to the nearest multiple of $120.

Increases in the earnings base and retirement test exempt amounts are not triggered by ad hoc increases in benefits. Further, the law does not require that they be reduced, if for instance average earnings were to fall.

Automatic benefit increases do *not,* however, trigger increases in the index for adjusting the "bends points" of the social security benefit formula or for indexing individual earnings histories.

—*Other programs affected by a social security benefit increase:* Other programs affected by automatic social security increases—

Supplemental Security Income (SSI), Railroad Retirement (a portion thereof), and Veteran's pensions (for nonservice connected disabilities)—raise their benefits automatically at the same time and by the same amount as social security increases. Benefits under various welfare programs also are indirectly affected, since any social security benefits received by recipients of those programs are considered in determining eligibility for and the amount of welfare benefits they receive.

After 1985 automatic social security increases will trigger increases in the premiums paid for Supplementary Medical Insurance (SMI) coverage under medicare. (This generally had been the practice in the past, but was superseded by legislation requiring specific premium increases in 1984 and 1985.) The percentage rise in the premium will be equal to the most recently paid social security benefit increase, not the current one.

III. Illustrative Proposals

This section illustrates a number of ways in which outlays savings could be achieved by altering the social security COLA provisions. It is not intended to be an exhaustive list, but to provide a broad spectrum of ideas.

Across-the-board COLA constraints

—*Provide less than a full COLA:* Typically these types of proposals follow one or the other of two basic forms.

Under the first, the COLA would be lessened by a certain percentage. This form of constraint is sometimes referred to as "CPI minus X"—X usually being 1, 2, or 3 percentage points. Other times it is seen as providing an increase only if, and to the extent, inflation exceeds a certain level. The net effect is the same. If, for instance, the CPI rose by 5 percent during the measuring period, the benefit increase actually paid would be 4, 3, or 2 percent.

This might be done for 1 or more years. Frequently, these proposals call for at least some minimum benefit increase to be provided, even if the percentage cut resulted in an increase below the 3-percent inflation threshold (which ordinarily would preclude an increase).

The second form would peg the benefit increase to some given percentage of a full COLA, as is sometimes done with private pensions. Under this approach, the benefit increase might be limited to two-thirds or three-fourths of the rise in the cost of living. Alternatively, a full COLA might be provided only up to a certain level of inflation (possibly with a partial COLA for the portion of inflation above that fixed level). Under this approach, a full COLA might be provided only if inflation were equal to or less than 3 or 4 percent. No adjustment, or only a partial adjustment, would be provided for the portion of the rise in the cost-of-living above that level.

—*Freeze the COLA or provide it less frequently:* Another similar way of cutting the cost of the COLA—similar in the sense that it would apply to all social security recipients—would be to delay it in some way.

One approach would be to delay the COLA, perhaps for a year. The benefit levels for those affected would be frozen in effect for a 2-year period. They would rise in subsequent years, but their benefits levels would be permanently lower than they otherwise would have been, because the benefit increases they subsequently re-

ceived would not reflect a year's worth of inflation. For instance, only 1 year's worth of inflation might be reflected in the first benefit increase after the freeze, even though the previous increase occurred 2 years earlier. Subsequent increases, in turn, would be built upon this lower benefit base. As a result, 1 year's worth of inflation would be permanently ignored for those affected, and savings would continue as long as these people received benefits.

Another approach intended to be more temporary in nature would be to delay the COLA by putting it on a biennial schedule for say 5 or 6 years. COLAs might be provided every 2 years based on a CPI measuring period of 2 years in length. This would produce savings every other year (for instance, in the first, third, and fifth years of a 6-year constraint period), without raising costs in the intervening and later years. After the period of constraint the COLA once again might be provided annually. As with the previous proposal, savings would have resulted during the next 5 or 6 years, but benefit levels at the end of this period would be the same as if the COLA had been provided annually.

Yet another less direct approach would be to raise the 3-percent trigger. Under current law, if inflation during a particular measuring period were less than 3 percent, no COLA would be authorized for the following year. Given the fact that inflation recently has been running at relatively low levels, if the trigger were raised to say 5 or 6 percent, it is quite possible that one or more COLAs could be delayed over the next few years. This would not cause benefits to be lower permanently, but savings would result from not paying the increase as soon as it otherwise would have been. The delay would mean that the measuring period of inflation would be longer—possibly being 2 years in length instead of one. Recipients would be caught up when the 2-year COLA was provided. As a contingency measure, in the event inflation became acute, the proposal also might include an exception permitting the COLA to be provided annually during the constraint period if inflation exceeded 5 or 6 percent in a year's time.

—*Shorten the CPI Measuring Period:* Another general form of COLA constraint would be to shorten the CPI measuring period in calculating the amount of each COLA.

This might involve, for example, basing COLAs on 9-month measuring periods for a number of years, rather than on 12-month periods. In contrast to the previous proposals, the COLAs would be paid at the same time they otherwise would (presumably annually). This too could be done permanently to produce long-range savings or temporarily to produce only near-term savings. If the intent were to create both short- and longrun savings, the 3-month segments omitted from the measuring periods during the year(s) of constraint would not be included in any subsequent benefit increases. If the intent were to produce only temporary savings, 15-month measuring periods could be used to compute the COLA(s) after the period of constraint (until benefit levels were brought up to what they would have been if the earlier measuring periods had not been shortened).

42-157 O - 85 - 3

With either of these approaches consideration also might be given to lowering or discarding the 3-percent trigger feature, so that the COLA would not be delayed inadvertently because inflation had not reached 3 percent due to the shorter measuring periods.

COLA constraints targeted away from low-income recipients

The motive behind this type of constraint usually is to target the COLA reductions away from recipients who presumably would suffer considerable economic hardship if the reductions were applied to them.

—*Means-test the COLA:* From time to time it has been suggested that the COLA be provided in full only to people in need—presumably those with incomes at or near poverty levels—through the direct measurement of a social security recipient's income and resources. This sometimes is referred to as means-testing.

In a literal sense, means-testing would require every social security recipient to report periodically his or her income (from all sources) and assets to a social security representative. The representative also would need the recipient's permission to verify the information reported. If the recipient's resources were below a certain dollar threshold—presumably an index of poverty or near poverty—a full COLA would be provided. If payment of a full COLA would cause the recipient's total income to exceed the threshold, a partial COLA (or no further COLA) would be granted once the income threshold were reached.

Social security benefits presently are not conditioned on any measure of need. Although an earnings limitation applies to recipients under age 70 who work, only 1.5 million people are asked to report their earnings each year. Personal assets and income from sources other than work are not measured. Thus, means-testing in a strict sense would require creation of a large new system to gather and verify the income and resources of the 36 to 37 million people who receive social security benefits each month.

A more limited approach might be to measure only a recipient's income, and ignore his or her assets. A further refinement might be to measure only certain forms of income. For instance, to simplify administration, only taxable income reported for income tax purposes might be measured. Alternatively, only earnings from work and other nonpension income might be measured. Or only income from public programs (Federal or Federal, State, and local) might be measured.

None of these approaches has been extensively examined in the past. Since they pose significant administrative and policy issues, a great deal of analysis would have to be done to assess their feasibility, particularly if they were to be implemented quickly to produce near-term outlay savings.

—*Tax the COLA:* A similar form of selective constraint would be to subject the COLA to income taxes. This approach would result in a progressive constraint of the COLA, since the higher a person's taxable income, the greater would be the taxes imposed on the COLA portion of his or her social security benefits (the higher a person's marginal tax bracket is, the greater would be the tax bite on the COLA).

Although there are various ways to identify what portion of a person's annual benefits was due to a COLA, the easiest might be to assume that the COLA was a given percentage of the benefits received during the year (ignoring reimbursement of past underpayments). For example, if a 5-percent COLA were provided, a recipient who received $5,250 in benefits that year would be required to report $250 (5 percent of $5,000) as ordinary income.

If the recipient's income were so low that no income tax liability existed, the result would be no cut in the COLA. If the recipient's income put him into an 11-percent marginal income tax bracket, the effect would be to cut his or her COLA by 11 percent; if in a 25-percent bracket, the effect would be a 25-percent cut in the COLA, and so on. This could be repeated each year, coupling each new COLA with those given in prior years to figure what portion of a person's annual benefits was attributable to COLAs.

In order to avoid double taxation, the proposal would have to be coordinated with the provision currently in the law making benefits of some recipients partially taxable. Legislation enacted in 1983 made a portion of social security benefits taxable for single people with taxable income in excess of $25,000 and couples with taxable income in excess of $32,000. Half of the benefits are counted in determining if the recipient's (s') income exceeds these thresholds, with half of the amount above the thresholds being countable as taxable ordinary income. One approach to coordinating the current provision with a proposal to tax the COLA would be to first count the COLA portion of the benefits received as ordinary income, and then use half of the remaining amount to figure whether any further benefits are subject to taxation.

In conjunction with the proposal, consideration also might be given to excluding a portion of the COLA from taxation (similar to the exclusion that exists for dividend income) so as to minimize the number of recipients who would be forced to pay income taxes merely because of their social security benefit increases.

—*Pay full COLAs only up to certain benefit levels:* Another related approach might be to target the constraint on recipients with social security benefits above a certain level. For instance, full COLAs might be applicable only up to the level of average benefits of a retired worker—currently about $450 per month. If the CPI rose by 5 percent, the maximum monthly benefit increase a recipient could receive would be $22.50. Thus, a full COLA would be provided to recipients with benefits at or below $450 per month. For recipients with higher benefits the $22.50 "cap" would result in less than a full inflation adjustment—with the percentage reduction being progressively greater the higher a recipient's monthly

benefits were. Under the previous example, for instance, the $22.50 increase for a person with a $600 monthly benefit level would represent only a 3.75-percent benefit adjustment; for a person with a $900 monthly benefit level it would represent only a 2.5-percent adjustment (which would reflect only half of the rise in the cost of living).

Other targeted COLA constraints

Generally the intent with these types of constraint is to focus the reduction on selective groups of recipients to emphasize certain features of the social security program while possibly weakening others.

—*Constrain the COLA for early retirees:* One such approach would be to constrain the COLA (reduce it, delay it etc.) for persons who elect early retirement benefits, i.e., who elect benefits before the so-called normal retirement age, which is currently 65—the argument being that early retirement should be discouraged. They would not receive full or timely COLAs until they reached age 65. At age 65 their benefits could be raised to the levels they would have been had they waited until age 65 to receive them, or they might be left permanently lower. No retroactive adjustments would be made. The constraint also might apply to their eligible family members.

—*Constrain the COLA for "auxiliaries":* Another selective approach might be to target the constraint on so-called auxiliary recipients, i.e., members of the family other than the worker on whose record the benefits are based—the argument being that the earnings-related principles of the program should be strengthened. A full COLA might be provided only to retired or disabled workers, with the constraint falling on the additional benefits provided to their family members.

In survivor cases, the family's benefits might be increased only to reflect the rise that would have occurred if the COLA had been applied solely to the deceased worker's own benefits.

—*Constrain the COLA for families with high "replacement rates":* Still another approach would focus the constraint on recipient families whose benefits are high relative to some measure of the past earnings of the family's principal wage earner(s). For instance, the COLA given to the family might be constrained, if total family benefits exceeded say 60 or 70 percent of the principal wage earner's(s') "high-3" years of past earnings, or some other measure of past earnings. Once again the constraint might be limited only to auxiliary recipients. Their COLAs would be reduced (or eliminated) to the extent that payment of them would raise the family's total benefits above the replacement threshold. The worker on whose record the benefits were based would not have his or her COLA altered.

Stronger "stabilizer" and "fail-safe" measures

Another whole set of ideas is geared more directly toward the financing of the social security program. They would attempt to make the program's financial condition less vulnerable to adverse economic conditions or unanticipated surges in recipient enrollment. Frequently, they are referred to as stabilizers or fail-safes. They are not usually intended to produce immediate outlay savings—they have more of a contingency role—however, if they were to be triggered, outlay savings would result.

Pegging benefit increases to the lower of the rise in wages or prices is one such measure. Legislation enacted in 1983 built a provision of this nature into the program. If the program's reserve of Federal securities were to fall below a certain level, the provision requires that the next benefit increase be based on the lower of the increase in wages or prices.

A stronger proposal would be to eliminate the trigger requirement, and simply base all future benefit increases on the lower of wage or price increases. Current projections do not suggest that wages will rise more slowly than prices any time in the near future. However, if they did, one or more future benefit increases would be based on wage growth regardless of the level of Federal securities posted to the social security accounts. This would result in savings to both the program and the Federal budget.

A related idea would be to base benefit increases on wage growth minus some specific percentage. Current long-range social security projections show the program to be in relatively sound financial condition. However, this favorable outlook is based heavily on the assumption that wage growth will outpace inflation on average by 1.5 percentage points per year. It has been suggested that this assumption should be built directly into the benefit increase provisions by requiring that future increases be based on annual wage growth minus 1.5 percentage points. Over an extended period of time, this would be expected to result in benefit increases equal to inflation, but there would be years in which the increases would be lower, and other years when they would be higher.

Yet another idea would be to adopt a contingency measure to address a wide range of unanticipated adverse financial situations. Such a provision would resemble, in a sense, the old "ad hoc" approach to providing benefit increases, in that future increases would be conditioned (and in part determined) by the overall financial condition of the program. The proposal would call for an automatic lowering of future COLAs, if the financial condition of the program became precarious i.e., if the program were relatively close to not being able to meet its immediate benefit commitments, or if it were projected to have a long-range financing deficiency. It would resemble the stabilizer provision of current law in that future COLAs would be reduced when the program's reserve of Federal securities was low, but would be different in that the cut in the COLA could result in a benefit increase even lower than one tied to the rise in wage levels. The COLA even might be eliminated if necessary to avoid a dangerous erosion of the program's reserve cushion.

IV. Issues With Reducing the COLA

Arguments for reducing the COLA

Proponents of constraining the COLA often view it as an ideal form of benefit constraint, both because it has been a major contributor to the rising cost of the program and because large sums of money can be saved without imposing a severe financial burden on any particular subgroup of recipients. It does not totally preclude someone from receiving benefits; nor does it reduce benefits. It merely lessens the amount of an increase. In essence, it has the potential advantage of being able to minimize the pain by dispersing it broadly among millions of recipients.

Proponents of constraint point out that social security is a large part of total Federal spending, and regardless of its separate source of revenues, it cannot be ignored if the enormous budget deficits of the Federal Government are to be reduced. They contend that major reductions in the deficits can be achieved only if there is a general feeling that sacrifices are being made across broad segments of society. If social security benefits were exempt, recipients of other Federal benefits would ask for similar treatment, and the current effort to deal with the deficit problem could unravel.

They argue that social security cannot really be removed from Federal budget making, because any surplus revenues it receives ultimately flow into the general fund of the Treasury (because such excess receipts are invested in U.S. Government securities), and any shortfall of revenues causes the Government to reduce spending on other activities, raise taxes or borrow elsewhere to repay the earlier loans it received from social security. In other words, the investment policies the program follows will cause it to affect the "official" budget in one way or another, whether or not it is part of that budget. In this regard, it might be noted that, contrary to popular belief, social security has increased Federal borrowing needs in all but 2 years since 1969, the year in which it became part of the so-called "unified" Federal budget.[4]

They argue that to ignore social security in budget making would impose an even greater (and unfair) burden of budget restraint on other functions of the Government. Some find it paradoxical that in recent years substantial budget restraint has been required of

[4] What frequently confuses people is the fact the social security trust funds (OASI and DI) have taken in greater income than they have spent in 8 out of 15 years since 1969, but part of that income has come from transfers from the general fund. These transfers have benefited the trust funds, but not the Federal Treasury since they did not result in new revenues for the Government.

various welfare programs (e.g. AFDC, food stamps, medicaid and low-income housing assistance), while the COLAs under social security—much of the costs of which go to well-to-do retirees—have gone unscathed. They contend that social security may be seen as a "contractual" responsibility of the Government, but in reality it is a large income-transfer program that differs from other social welfare programs only in the sense that it conditions its payments on very loose measures of contributions, rather than on need. They argue that it is unfair to impose sacrifices on the neediest in society who rely on these other needs-tested income-transfer programs, while many social security recipients with moderate and high incomes receive large COLAs.

In connection with this, the argument is made that even if there were not enormous Federal deficits, the COLA expenditures in conjunction with increases in defense expenditures would soak up any new resources that might become available each year, and thereby preclude new spending on other critical social and environmental issues—they pre-empt spending on other problems of major national importance. Similarly, it is argued that even within the framework of social security alone, the COLAs cause a resource drain that precludes other potential improvements of the protections afforded by the program.

It further is argued that while in the past poverty was more prevalent among the elderly than in the population generally, this is no longer the case. Therefore, some would contend that it is only fair to ask social security recipients to share, by accepting smaller benefit increases, in the sacrifices that other segments of the population may be asked to make to reduce the budget deficits. While poverty among social security recipients might rise initially from a COLA constraint, failure to enact a major deficit-reduction package—proponents of which say cannot be achieved without across-the-board sacrifices could eventually impair economic growth and lead to higher levels of poverty overall.

From another perspective it can be argued that the automatic COLAs have kept Congress from practicing the fiscal oversight of the social security program that it conducted regularly when benefit increases were provided on an ad hoc basis, i.e. when Congress had to pass a law each time it wanted to provide an increase. Prior to 1975, whenever a benefit increase was given, it was accompanied by a reevaluation of the financial condition of the program (and if the program couldn't afford the increase, additional taxes were levied or "expectations" were lowered). It is argued that this fiscal propriety is not exercised today because benefit increases are automatic, and that this lack of fiscal control led to the two major financing crises the program confronted in the past 10 years.

Critics of the automatic COLAs acknowledge the existence of the so-called "stabilizer" provision enacted in 1983 (intended to lessen the adverse financial effects on the system of certain economic conditions); however, they argue that the stabilizer is not a strong enough measure to assure the financial integrity of the program. They contend that when the program's reserve balance is low, the

COLA should be constrained not just to the size of the average wage increase when inflation outstrips wage gains, but that it should be delayed or reduced to whatever extent necessary to maintain financial solvency. This, they argue, would force Congress to come up with additional resources for the program if it did not want to delay or constrain the COLA.

A related argument is made that in the 1978–82 period the CPI–W overstated the true rate of inflation by the way it measured the rise in housing costs. This, critics contend, caused excessive benefit increases and aggravated the financing problems already confronting the system then because of poor economic conditions. Various analyses show that an experimental CPI (the so-called CPI–X1), which measures "rental equivalency" instead of homeownership costs, would have triggered lower benefit increases in the late 1970s and early 1980s if it had been operational then. It might be noted that over the period 1975 to 1985, automatic benefit increases cumulatively totaled 108.3 percent, while the CPI–X1 rose by 103.9 percent.

Some critics further argue that while current projections show social security to be solvent for many years, the margin of safety for the next few years is slim. A significant economic downturn could at least temporarily renew the financing problems the program faced a few years ago. They point out that it is the 1985 to 1988 period in which the program will be most vulnerable to these problems. A near-term COLA constraint could help militate against these problems, possibly avoiding another major financing crisis later in the decade. They further contend that medicare is projected to have financial problems beginning some time in the 1990s, and COLA constraints could help offset other reductions in health care services or further tax increases (by reallocating excess OASDI resources resulting from the COLA constraint to medicare).

In addition, it has been argued that the COLA is too clumsy a vehicle to use to protect low-income elderly persons from slipping into (or further into) poverty. Social security benefits go to rich and poor alike, and many recipients would not suffer unduly if their social security benefits were not fully inflation proof. Since social security benefits are provided without a needs test, the indiscriminate payment of COLAs bolsters the view of those who feel that the program has poorly constructed welfare elements and that needs-tested welfare programs are better vehicles to achieve anti-poverty objectives. Census data for 1982 suggest that only $1 out of every $10 expended on social security benefit increases went to people whose incomes fell below the official poverty line.

Finally, there is the underlying economic thesis that the existence of automatic COLAs, whether they be built into Government benefit programs such as social security or in labor contracts, helps to perpetuate an inflationary spiral in the economy. The argument is made that the automatic escalators contribute to inflationary tendencies because they instill an underlying expectation of inflation. Critics contend that whatever the short-run effects of constraining automatic COLAs, the general erosion of them—not just

social security's—would be beneficial for the economy in the long run because such action would help to erode that element of inflation perpetuated by "inflation expectations."

Arguments for retaining the present COLA provisions

Those who oppose constraining the automatic COLA argue that it is a fundamental feature of social security. As such, they see any tampering with it to save money as a symbolic issue—that the implied compact the Government has with workers is abridgeable. They view a reduction of the COLA as breaking a perceived promise that in return for the payment of social security taxes, a worker will earn rights to social security benefits. They argue that if the COLA is reduced—especially for overall budgetary purposes and not because the program itself has financial problems—latent public apprehension about the ability of the program to meet its commitments might be rekindled. The public would view the COLA constraint as another example of piecemeal erosion of the program's protections, fueling pessimistic feelings that social security cannot survive over the long haul. They fear that those perceptions would be nurtured by program critics wishing to dismantle social security altogether.

Advocates also argue that the automatic COLA is one of the most useful features of the social security program. Other sources of retirement income—pensions, savings, investments, etc.—are either rarely adjusted for inflation or the adjustment is much less than that needed to maintain their original purchasing power. They argue that the social security COLAs allow people to plan rationally for their retirement, knowing that they can count on at least one source of retirement income maintaining its purchasing power over time. To erode or take this feature away would disrupt people's lives and plans.

Related to this is the argument that the automatic COLAs given during the past 10 years—a period of often rapid inflation—helped many recipients maintain reasonable standards of living. Some even allege that the COLAs were the single most important feature of the program in terms of keeping many elderly persons out of poverty. It can be argued that many retirees, widowed spouses, orphans, and disabled people would have a difficult time absorbing a cut in their purchasing power. While many social security recipients are fairly well off, in fact the other income of most elderly recipients is quite modest. Survey data for 1983 suggest that 73 percent of unmarried social security recipients, age 65 and older, had less than $5,000 in income from other sources (39 percent of married couples, at least one of whom was 65 or older).[5]

Similarly, while the percentage of the elderly in poverty is about the same as it is for the general population, a higher proportion of them have "near poor" levels of income (defined as within 125 per-

[5] Estimates developed by the Congressional Research Service based upon incomes reported in the March 1984 Current Population Survey conducted by the Bureau of the Census.

cent of poverty level income). A recent study done for the American Association of Retired Persons estimated that if the January 1986 COLA were reduced by 3 percentage points, the number of elderly people living in poverty would rise by half a million in 1986.[6]

In this regard, program advocates are likely to be concerned that attempts to target COLA constraints on moderate and high-income recipients, so as not to harm poor or relatively poor recipients, could lead to some form of means-testing of social security benefits. They would fear that recipients generally would object to having to disclose their income and resources (they would find it demeaning), and as a result public support for the program would decline.

In response to criticism that social security COLAs were in excess of the "true" rate of inflation in the late 1970s and early 1980s, it can be argued that the problem causing the CPI to overstate inflation now has been corrected. Many economists contend that the way the rise in homeownership costs was reflected in the CPI overstated inflation during those years, but this situation was corrected in January 1985 (in computing changes in the CPI-W) by the adoption of a new method of measuring the costs of housing, the so-called rental equivalency method.

Of related significance is the fact that the January 1984 COLA did not fully reflect the rise in the cost of living due to the intentional omission of 6 months' worth of inflation in 1983 in computing that benefit increase. Also, the dampening of housing price increases and the reduction in mortgage interest rates accompanying the last recession caused the CPI-W to understate inflation (in contrast to an alternative CPI measure that reflected rental equivalency), and resulted in COLAs in January 1984 and 1985 that did not fully reflect the rise in the cost of living. The aggregate amount of the past two benefit increases was 7.1 percent, but the CPI, adjusted to reflect rental equivalency in lieu of the homeownership costs (under the so-called CPI-X1), rose by 11.5 percent from first quarter of 1982 to third quarter of 1984.

It also can be argued that when wage increases and inflation are viewed historically over long periods, wages on average have tended to rise considerably faster than inflation. While during the adverse economic periods of the past 10 years social security recipients may have fared better through their COLAs than workers did through their wage increases, social security recipients won't do as well when economic times are better—they won't get to share in the productivity gains achieved by workers (unless Congress were to enact ad hoc increases surpassing the rise in the cost of living).

And even though social security benefits matched the rise of the CPI during these recent adverse periods, for many retired persons social security was the only form of income that kept up with inflation. A worker's earnings may not have totally kept up with inflation, but a substantial portion of a retiree's income from sources other than social security may not have risen at all—it was fixed.

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[6] Data Resources, Inc., "Simulating the Effect of 'CPI-3 percent' on Elderly Incomes Using the DRI-AARP Model" Washington, D.C., January 9, 1984.

Yet another argument can be made that the financing problems confronting the social security cash benefit program were largely resolved by the amendments passed in 1983 and that the program now should be able to "finance itself" for many years into the future. Even if financing problems should re-emerge—as some analysts suggest could happen in the next few years if the economy takes a turn for the worse—the law now contains a contingency "stabilizer" provision, which could cut down on the size of future benefit increases if inflation outstrips wage growth and the program's reserve cushion is low.

Moreover, social security's revenues are projected to exceed its expenditures continuously over the next four decades, creating a situation in which the program would actually help reduce Federal borrowing and crowding out in the private market. Excess social security tax receipts would be invested in U.S. Government securities and as a result reduce the amount the Treasury would have to borrow from the private sector to maintain other programs financed out of the general fund. It, thus, can be argued that it is the general fund programs that need restraint, not social security.

Peripheral issues with reducing the COLA

Beyond these philosophical arguments, there are other factors that have to be considered in reducing or constraining the social security COLA.

—*Effect on social security financing:* The first is the question of how the savings arising from a COLA constraint should be utilized with regard to the financing of the social security program.

If a COLA constraint were enacted for budgetary purposes, the savings it produced would not only improve the deficit situation, but the financial condition of the social security program as well. Under current projections, and without further alteration of the program or its financing provisions, social security appears to be on a progressively improving financial footing with its income projected to exceed its outgo in each of the next 40 years. In fact, beginning in the early 1990s, the program's reserve of Federal securities is expected to exceed a level equal to 100 percent of its annual expenditures and eventually exceed 500 percent of its annual expenditures early in the next century (i.e., about $1 trillion in terms of 1985 expenditures).

The question this raises is if significant savings were projected to arise from a measure to constrain the COLA, should the social security trust funds simply be credited with an even larger balance of Federal securities, or should the financing provisions of the program be altered? Because the program's contingency reserve is projected to be quite slim until the end of the decade, there may be some consensus to allow the reserve to build up initially. However, if the savings were substantial, a number of policy questions about the program's financing would arise, particularly for the latter portion of this decade and later years.

For instance, should the increases in social security (OASDI) taxes now scheduled in the law for 1988 and 1990 be delayed or lessened (presumably after the budget deficit problem had been lessened), because of the expected accumulation of unnecessary reserves? Should the transfers made to social security from the general fund be reduced or eliminated (e.g., the crediting of the trust funds at the beginning of each month for estimated monthly FICA tax receipts and the infusions representing the additional income tax proceeds arising from taxing social security benefits)? Or should the savings be indirectly given to the medicare hospital insurance (HI) program through a reallocation of the overall FICA tax (because of looming financial problems projected to confront the HI program at some point beginning in the 1990s)?

—*Potential benefit "notches"*: Another issue to be addressed is that reducing or constraining the COLA could produce an unintended "notch"—or benefit disparity—between recipients of slightly different ages, who have similar wage records.

There are two forms of indexing in the social security program. One raises the benefits of people on the rolls (and those eligible but not yet receiving benefits) to take inflation into account. The other raises (or indexes) earnings histories and the benefit formula used to compute the initial benefit awarded to new recipients to take changes in national wage levels into account.[7] The inflation adjustment for people already receiving or eligible for benefits is effective with benefits due for the month of December (which actually are payable in January). The benefit computation adjustment for new eligibles is effective for the month of January. People becoming newly eligible each year do not receive the previous December's inflation adjustment given to those eligible then, but instead receive the wage-induced adjustment that became effective in January of the year they became eligible.

Generally, this dual indexing process results in fairly comparable benefit levels for people with similar work histories, who are close in age but whose birthdays fall in different calendar years. For instance, using long-range social security actuarial assumptions (the so-called intermediate II-B ones), a worker retiring in the future at age 62 could expect to receive a benefit increase of 4 percent in December of that year. Another worker, who retires at age 62 in the following year, will not receive the previous month's benefit increase, but he can expect his initial benefit award to include a 5.5-percent adjustment, reflecting the rise in national wage levels (once again, using long-range social security assumptions). In theory, the benefits of these two workers would differ by only 1.5 percentage points.

This small increase in benefits for each successive group of newly eligible recipients is viewed as unavoidable, if the value of initial social security benefits of future recipients is to keep up with a rising standard of living. As wage levels rise over time, the level of

[7] In contrast to the inflation adjustment made to the benefits of people receiving or eligible for benefits, which cannot be downward, the wage adjustment made in the initial benefit computation of new eligibles can be upward or downward under present law.

new social security benefit awards would have to rise with them, if the benefits are to maintain their relative role as a retirement income source. Thus, although not perfect, it is assumed that benefit equity between successive groups of recipients will be maintained as long as both the CPI adjustment (i.e., the COLA) given to existing recipients and the wage-induced adjustment given to new eligibles were done in tandem.

However, if there were to be a large difference between the inflation-driven COLA and the wage-increase adjustment, or if one were to be provided and the other were not (for instance, because of a COLA freeze), notable differences in benefits could arise between groups of people becoming eligible in two different consecutive calendar years. This, in turn, very likely would lead to complaints of inequity from those receiving the lower benefits.

For instance, in the example given above, if a COLA for existing recipients were delayed for a year (due to a freeze), a person becoming newly eligible in December of the year of the delay would receive benefits that are about 5.5 percent smaller than someone with a comparable earnings record who became eligible the following month (i.e., in January of the next year). If the benefit increase given the following December included a catch-up adjustment for those affected, the 5.5 percent difference would exist for only 1 year.[8] However, if a catch-up COLA were never given, the benefit differential would continue indefinitely. For workers with average earnings, the difference could amount to $265 per year in today's dollars (assuming the affected recipients retired in 1985 and 1986, respectively).

This problem could be addressed by eliminating the wage-induced adjustment to the benefit computations of those becoming newly eligible in the following year, assuming the freeze were intended to produce long-term savings, or delaying the adjustment until a catch-up increase was provided to those who did not receive a COLA the previous December.[9] If, alternatively, the COLA were reduced rather than eliminated or delayed, the wage-induced adjustment could be reduced by a similar amount; once again, indefinitely or until a catch-up COLA was provided.

—*Potential "windfall" benefit increases:* A third issue to be considered in reducing or constraining the COLA is that potential "catch-up" increases given at a later time could, if patterned after existing law, be inadvertently paid to persons who never were af-

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[8] A flaw in existing law would have to be corrected to avoid inadvertently giving the subsequent cohort of new eligibles the catch-up increase that was intended only for those who actually missed the COLA the previous year—see the next issue, which discusses potential "windfall" benefit increases.

[9] If the catch-up COLA were delayed beyond the following year, the foregone wage-induced adjustment similarly would have to be delayed again. In addition, the wage-induced adjustment would have to be omitted from the new benefit computations of the next cohort of new eligibles, in order to avoid creating a similar later "notch" between the next two cohorts (i.e. delayed until the catch-up increases—both COLAs and wage-induced adjustments—were provided to the earlier affected cohorts). The delay of the wage-induced adjustment to new benefit computations would have to pertain to both earnings histories and the benefit formula.

fected by the earlier loss of a COLA (or a portion thereof).[10] These would be recipients who became eligible after the year the COLA was constrained, but were eligible at the time a catch-up increase was given. They would not have lost any benefits as a result of the COLA constraint, but could be advantaged by its restoration if a catch-up increase were given to everyone who was eligible then. In other words, in constraining the COLA, consideration would have to be given to who the recipients of any later catch-up adjustments should be.

If, for instance, a benefit increase were delayed for a year, or alternatively, if benefit increases were made biennially for a period, cohorts of new eligibles not affected by the delay potentially could benefit from a catch-up increase if the means of providing such an increase were simply to extend the length of the CPI measuring period from 1 year to 2 years. They would receive not only the wage-induced adjustment made when their initial benefit awards were computed (as described in the previous issue), but 2 years' worth of inflation adjustments as well. As a result, they would receive an extra year's worth of an inflation adjustment, and because they also received the wage-induced adjustment, a "notch" similar to the one previously described would be created between them and the previous cohort of new eligibles.

This problem could be avoided by not providing the same benefit increase generally to all recipients at the time a catch-up increase was provided. Instead, the benefit levels of each cohort of social security recipients would be restored to the levels they otherwise would have been had the COLA not been constrained.

—*Effect on the social security taxable earnings base:* Another issue to be addressed is whether the social security taxable earnings base provision should be altered.[11] Under current law, an automatic benefit increase triggers a simultaneous rise in the maximum amount of earnings subject to the social security tax (although the increases are usually different in size.[12]

This link, which has existed since the automatic benefit increase provision was enacted in the early 1970s, was made in large measure to help provide the resources needed to cover the added costs of the COLAs. If the COLAs were to be reduced or delayed, the basic policy question would arise of whether the increase in maximum taxable earnings should be reduced or delayed as well.

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[10] There are a number of ways to provide a catch-up increase. However, the approach envisioned here is the restoration of the monthly benefit levels that would otherwise have resulted if the COLA had not been altered, without providing lump-sum retroactive payments for the benefits lost during the period of constraint.

[11] A related feature of the program also requiring consideration if the COLA were to be constrained is the exempt amount of the social security earnings test. Under current law benefits are withheld if a recipient's earnings from work exceed certain levels—$5,400 for persons under 65; $7,320 for persons age 65 and older. As with the taxable earnings base, these exempt amounts are raised whenever a COLA is triggered. Thus, a COLA constraint raises the question of whether and by how much these thresholds should be similarly constrained.

[12] In contrast to the benefit increase, which is keyed to inflation, the taxable earnings base and the exempt amounts under the retirement test are increased at the rate that average wages rise.

Under current law, if a COLA were not triggered because inflation did not reach the 3-percent trigger level, the taxable earnings base similarly would not rise. Thus, if a provision were adopted simply eliminating or delaying the COLA in a given year, the rise in the taxable earnings base also would be eliminated or delayed (absent a special provision to the contrary).

Obviously, if the intent of constraining the COLA were to reduce budget deficits, the outlay savings would be eroded by revenue losses from constraining the rise of the taxable earnings base. In other words, the effect on the budget deficits from a COLA constraint would be increased by removing the link between the automatic benefit increase and the taxable earnings base—i.e., the earnings base would be permitted to rise by the amount it otherwise would go up, regardless of any potential COLA constraint.

However, even a measure that simultaneously delayed the COLA and the taxable earnings base increase would result in outlay savings that were larger than the revenue losses in the short run (at least under current economic projections).

In the long run, the effects of a dual constraint are not so clear. A net financial gain would arise only if the dual constraint were temporary in nature. If it were permanent (i.e., maybe imposed only one time, but with no catch-up provision), the long-term revenue losses of slowing the rise of future earnings bases would eventually overrride the favorable outgo effects of the COLA constraint. The COLA constraint would only affect those persons then eligible, and at some future point the annual savings from it would cease. The earnings base, on the other hand, would be permanently lower than it otherwise would have been, thereby creating an indefinite revenue loss.[13]

This actually might be viewed as a desirable effect in the 1990–2020 period, when social security revenues are projected to greatly exceed its outgo. However, in later years it would add to a projected shortfall of revenues and thereby weaken the long-run financial condition of the system.

—*Effects on other programs:* Yet another set of considerations revolve around the potential effects a social security COLA constraint might have on other programs. A number of them are described here.

Supplemental Security Income (SSI) benefits and Veteran's pension benefits—which are means-tested welfare type payments for needy elderly and disabled people—are tied directly to automatic social security increases. If the social security increase were constrained, should the benefits of these programs be permitted to rise regardless? On the one hand, it can be argued that these people are among the neediest in society and should be protected against inflation to the fullest extent possible. On the other hand, it can be

[13] A lower earnings base also implies lower eventual benefits—since less earnings would be posted to earnings records and used to compute social security benefits. However, actuarial calculations suggest that the long-run revenue loss would exceed the benefit savings by a 2-to-1 ratio.

argued that they should not be treated preferentially over social security recipients who had to earn their benefits by working.

Railroad retirement "tier one" benefits—payments provided to retired railroad workers and their survivors that are basically identical to social security benefits—are also tied to automatic social security increases. It is argued that since these are basically social security benefits under a different label, they should be subject to the same constraints imposed on social security benefits. However, railroad retirement annuitants already have had to absorb recent budgetary constraints through erosion of the inflation adjustment made to their staff pension benefits—so-called "tier two" benefits. (While tier one benefits—the social security counterpart—went up in the past 2 years, these increases were largely offset through a reduction in tier two benefits.)

Increases in premiums paid by persons covered by the Supplementary Medical Insurance (SMI) program (part B of medicare) have been triggered in the past by increases in social security benefits. Recent legislation, intended to increase the portion of the SMI program financed by its recipients (relative to the share financed through general revenues), temporarily altered this triggering process. However, beginning in 1986, the triggering process will be resumed. Thus, if a social security COLA were constrained or delayed, the rise in the SMI premium would be similarly affected, resulting not only in a cut in governmental revenues (looking at it from the budget perspective), but increasing the share of the program that would be financed with general revenues. If, alternatively, the SMI premium were permitted to rise when the COLA was constrained or delayed, the budgetary effects would be favorable, but the amount most social security recipients actually received in their checks would be cut below pre-existing levels (since most social security recipients covered by the SMI program have the premiums automatically deducted from their monthly checks). This would likely result in considerable confusion and misunderstanding, which in turn could spark a heavy volume of complaints that social security benefits have somehow been cut.

For a number of other programs the effect of a COLA constraint or delay would be indirect, in the sense that it would keep the benefits provided by them from falling. Specifically, food stamps, aid to families with dependent children (AFDC), medicaid, and certain other public assistance programs generally do not provide benefit increases or raise their eligibility thresholds at the same time and by the same amount as a social security COLA. Since assistance under these programs is conditioned on need as reflected by the level of a person's income and assets, the recipients in these programs who also receive social security frequently see their assistance payments go down (or their eligibility taken away) as their social security benefits rise due to a COLA. If the social security COLA were constrained or delayed, the assistance they receive from these programs would not be lowered (and total expenditures under these programs would be higher than they otherwise would have been, at least temporarily).

APPENDIX

Historical Development of the Social Security Cost-of-Living Adjustment

Summary

While the first automatic benefit increase under social security did not take place until 1975, the thrust for such a provision goes back at least to the mid-1960s. When considering H.R. 6675, the Social Security Amendments of 1965 (which among many other provisions authorized the creation of the Medicare and Medicaid programs), the Senate considered and rejected an amendment by Senator Jack Miller (of Iowa) to increase social security benefits by 3 percent automatically whenever the cost of living rose by 3 percent (actually the amendment called for benefits to be increased by increments of 3 percent for each full 3 percent rise in the CPI). In the debate Senator Miller repeatedly noted that automatic increases in benefits already had been authorized for Federal civil service annuitants in 1962.[1]

Numerous other proposals arose during that period, and in 1968 the idea received national prominence when both the Republican and Democratic parties included proposals of this nature in their platforms. In the 4-year period 1969 through 1972, the Nixon administration repeatedly proposed an "automatic" procedure as part of the administration's legislative program for social security.

It should probably be noted that while there was a broad base of support for the idea, it was for the most part a conservative measure. The late 1960s through early 1970s was a period when there was considerable congressional interest in making major boosts in social security benefits. In fact, between February 1968 and January 1971, benefits were raised 3 times: by 13 percent, 15 percent, and 10 percent respectively, which when compounded resulted in an aggregate increase of 43 percent. This aggregate increase substantially exceeded the 27 percent rise in the CPI that occurred from 1965 to 1970.

Even with these three increases, pressure to raise benefits persisted. As a result, interest in making benefit increases automatic

[1] Congressional Record. Senate. July 8, 1965. Roll Call No. 166. Also see discussion on July 7, 1965, Congressional Record, pp. 15273-15279.

grew. Those concerned with the large increases that had taken place felt that an automatic provision would dampen the almost constant political pressure to raise benefits and that pegging benefit increases to the rise in the CPI would result in lower increases than Congress would be likely to enact on an ad hoc basis.

This is not to suggest that expansionists opposed the idea. Some viewed it as a "minimum" measure, which could be augmented by further ad hoc increases. There also was appeal to the idea of avoiding the substantial time lags between benefit increases that frequently had been the rule in the past. No general benefit increase was provided in the first 10 years of the program. More than 4 years went by after the 1954 increase, 6 years after the 1959 increase, and 3 years after the 1965 increase.

The automatic increase provision eventually was enacted in 1972, and was altered five times in the following 11 years, twice before the provision even became effective in 1975.

Legislation in 1970

H.R. 17550 [2]

The first serious action taken by Congress to create an "automatic" procedure was with H.R. 17550, the Social Security Amendments of 1970. When reported out of the Ways and Means Committee, H.R. 17550 contained a number of measures for social security, medicare, and medicaid. Among them was a provision calling for a one-time 5 percent increase in social security benefits effective for January 1971. It did not include an "automatic" increase feature, but a floor motion by the Republican leadership to recommit the bill resulted in an additional House-passed provision which would provide for automatic benefit increases (for 1973 or later) whenever the CPI rose by 3 percent or more.

A similar measure was passed by the Senate. However, it passed the Senate late in the session, and the 91st Congress expired before a conference of the House and Senate could be convened.

Legislation in 1971

Public Law 92-5 and H.R. 1

Early in the next Congress, a one-time benefit increase of 10 percent was enacted (Public Law 92-5), effective January 1, 1971 (the Senate-passed version of the benefit increase provision of H.R. 17550 called for a 10-percent hike rather than the 5 percent as contained in the House-passed bill). No "automatic" provision was included. In signing the bill, President Nixon restated his desire to see future increases placed on an "automatic" basis.

His press announcement stated:

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[2] Segments of the following summary of legislative action occurring from 1970 to 1973 are based on a description contained in Paper No. 18 of Studies in Public Welfare, published by the Subcommittee on Fiscal Policy of the Joint Economic Committee, dated December 27, 1974. See the chapter by Francis Crowley entitled "Financing the Social Security Program—Then and Now."

> I have signed H.R. 4690, which in addition to raising the ceiling on the national debt, also increases social security benefits by 10 percent. . . . Unfortunately, however, the measure does not include the vital cost-of-living escalator. I have repeatedly asked the Congress to provide for automatic increases in social security benefits as the cost of living increased. Only if such a provision is included can we overcome the rigidity of the social security benefit system, and the long delay that ensues before senior citizens receive the real benefits of a system that most have supported by their contributions throughout their adult lives.

Shortly thereafter, the 1971 Social Security Advisory Council made a similar recommendation. Later that spring, the Committee on Ways and Means reported out, and the House passed, H.R. 1, containing major social security, health, and welfare amendments. It included a provision calling for another 5 percent benefit increase to be effective for June 1972, and for future increases to be pegged automatically to changes in the CPI, effective for January 1974 (if triggered) and thereafter. The Senate Finance Committee held hearings on the bill that summer, but no further action was taken until 1972.

Legislation in 1972

The "Mills" Bill (H.R. 13320) and the "Church" Amendment (Public Law 92-336)

The Senate Finance Committee held hearings again early in 1972 on H.R. 1, but in the meantime pressure had begun to mount for another major benefit increase. In February 1972, Representative Wilbur Mills, then Chairman of the House Ways and Means Committee, introduced H.R. 13320 calling for a one-time 20-percent increase in benefits and an automatic increase provision similar to the one contained in H.R. 1. A few months later when the Senate was considering H.R. 15390, a bill to extend the public debt limit, an amendment introduced by Senator Frank Church was passed with basically the same benefit increase measures as contained in the Mills bill, including the automatic feature for future increases. H.R. 15390 as modified by the Senate was agreed to by the House on June 30, 1972, and was signed into law by President Nixon on July 1, 1972. It became Public Law 92-336.

This legislation provided that benefits would be raised automatically beginning in January 1975. The taxable earnings base also was to be increased from $9,000 to $10,800 for 1973 and to $12,000 for 1974, and starting in 1975, it would be increased automatically in tandem with increases in average covered wages whenever benefits were automatically increased.

Legislation in 1973

Public Law 93-66 and Public Law 93-233

The CPI rose rapidly in the first 6 months of 1973. Reacting to this situation, in June 1973 the Senate Finance Committee added

an amendment to a House-passed bill authorizing a continuation of the temporary increase in the public debt limit (H.R. 8410). Under the committee amendment, the first automatic benefit increase was to be provided in January 1974, rather than January 1975, based on the rise in the CPI from June 1972 to June 1973. The benefit increase was estimated to be 5.6 percent based on the June to June CPI increase (it actually turned out to be 5.9 percent).

The committee viewed its benefit increase as an advance on an increase that otherwise would have taken place later, and therefore saw no need to raise revenues to balance the additional costs. (The system's reserves were adequate to absorb the added cost in 1974.) However, when this legislation went to conference, the administration objected to the benefit increase on grounds that it would increase the budget deficit for fiscal year 1974 by increasing expenditures without increasing revenues. Accordingly, the conferees agreed to postpone the increase until June 1974 (the checks would be issued in July) so that the additional expenditures would not come until the start of the next fiscal year (1975). In addition, to help meet the additional costs, the annual tax base scheduled to go into effect in January 1974 was raised from $12,000 to $12,600.

Because of a difficult parliamentary situation in the House, instead of adopting these provisions as part of the debt ceiling extension, they were taken up as a Senate amendment to a bill extending the Renegotiation Act, and were enacted as part of Public Law 93-66.

Following enactment of Public Law 93-66, pressure again surfaced to provide the increase earlier than scheduled (i.e., before July 1974). The CPI had continued to rise at a rapid rate and there were complaints that the automatic 5.9 percent increase (which reflected an earlier period of inflation) would be inadequate. In October 1973 the Senate responded by adding a Finance Committee provision to a House-passed welfare related bill, H.R. 3153, to increase social security benefits by 7 percent to be effective upon enactment, in lieu of the 5.9 percent increase scheduled for the following July. Like the scheduled increase, the committee considered the proposed increase an advance on the January 1975 automatic increase.

The Committee on Ways and Means also reconsidered the 5.9 percent benefit increase and reported out a measure, as part of H.R. 11333, providing for a two-step 11 percent benefit increase, with 7 percent payable in April 1974 and the remainder in July 1974. It delayed the next automatic increase from January 1975 to July 1975, and made future automatic increases payable in July, instead of January, thereby coordinating them with the beginning of future fiscal years. In tandem with this change the CPI measuring period was changed from a second quarter to second quarter basis to a first quarter to first quarter basis, thus shortening the lag period, from 6 months to 3, between the end of the measuring period and the month the benefit increase would become effective. The provision also called for the earnings base to be increased to $13,200, effective for January 1974 (rather than to $12,600 as authorized earlier in the year), and the tax rates to be revised for the

next few years in order to shift some of the tax receipts that otherwise would have gone toward the hospital insurance program (which projections showed to be over-financed in this period) to the cash benefits program, and then increased beginning in 1981.

When House and Senate conferees met on H.R. 3153, they reached an informal agreement as to what provisions would be recommended to their respective bodies, including the benefit increase provisions contained in the House bill. The Finance Committee already had reconsidered its decision to provide a 7-percent benefit increase, and had agreed to a modified version of the two-step 11 percent increase contained in H.R. 11333 passed by the House. However, the parliamentary situation with H.R. 3153 became tangled, and the conference was recessed, subject to the call of the Chairman. Senator Russell Long, Chairman of the Finance Committee, then brought the House-passed bill, H.R. 11333, to the Senate floor, where he made a motion to substitute for H.R. 11333 those provisions of H.R. 3153 that had been agreed to by the conferees. This amended bill passed both houses with substantially the same social security benefit and financing provisions as in the House-passed version of H.R. 11333, and was signed by President Nixon on December 31, 1973, becoming Public Law 93-233.

Legislation in 1977

Public Law 95-216

Legislation affecting the automatic increase provision did not emerge again until Congress took up the 1977 social security amendments. These amendments were aimed primarily at shoring up the financial condition of the program, which had deteriorated seriously over the preceding 4 or 5 years. Among many measures the amendments called for a major overhaul of the way benefits would be determined for social security recipients who became eligible after 1978.[3] Their benefits would be computed using newly devised procedures that would not tie initial benefits directly to "earlier" benefit increases as they had been up until then.

At that time there was much concern that the initial benefits of new recipients were growing too quickly and would continue to do so in the future, and thereby threaten the long-range solvency of the system. Initial benefit levels were rising such that it was possible they would exceed the typical worker's preretirement earnings by some point early in the next century.

The problem arose because automatic benefit increases were given not only to existing social security recipients, but to all future recipients as well (the percentage increases of the past were built into their newly awarded benefits). This procedure turned out to be flawed, because it was causing new benefit awards to rise too rapidly, but more critical was the fact that the extent of their growth in the future was totally unpredictable. Enactment of the

[3] One of the revenue-producing measures was to substitute ad hoc increases in the taxable earnings base for automatic increases that would have taken place in 1979 to 1981. The new increases permanently raised the base to higher levels than otherwise would have resulted from the automatic procedures.

new computation procedures was expected to bring predictability to future benefit determinations and to resolve more than half of the system's long-range financing problems that were projected then.

The benefit computation problem had been explored at length by the 1975 social security advisory council, which recommended the broad outline of the new computation procedures ultimately adopted by Congress. In 1976 the Ford administration, as part of its plan to shore up the financial condition of the program, recommended similar measures, as did the Carter administration the following year. The House Ways and Means Committee agreed to a roughly comparable plan as part of H.R. 9346 in September 1977, and the House passed it the following month. The Senate Finance Committee took action at about the same time, and adopted related measures as amendments to H.R. 5322 (which was a minor tariff bill that had passed the House). In November, these measures were substituted on the Senate floor for those contained in the House-passed bill, H.R. 9346, and adopted by the Senate. Conferees for the House and Senate reached agreement in December 1977. Although there were a number of differences between the House and Senate versions of the new computation procedures, both versions called for the same treatment of benefit increases in the initial computation of benefits: only benefit increases occurring in the first year of eligibility and later would be factored into new benefit awards.

While existing recipients were largely unaffected by the new computation rules, some modest benefit savings arose from a provision that tied future benefit increases given to early retirees (persons joining the rolls before age 65) more precisely to changes in the cost of living. Up to that point, early retirees had received benefit increases that were greater than the rise in the CPI largely because such increases were not reduced to reflect the proper actuarial reduction in benefits that early retirees are required to take. The 1977 change affected existing and future recipients. It had been in both the House and Senate bills.

The Senate bill, however, differed from the House bill in one respect by calling for a semi-annual benefit increase whenever the cost of living rose by 4 percent or more in a 6-month period (an amendment by Senator Church). It was dropped in the conference.

Legislation in 1983

Public Law 98–21

From 1977 to 1982 the automatic increase provisions again operated without congressional modifications. However, the financial condition of the system continued to deteriorate during this period largely as a result of rapid inflation which caused large benefit increases that greatly increased expenditures, and wage growth that lagged behind inflation, not allowing tax revenues to keep up with the higher expenditures. The fact that inflation had contributed to the system's financial problems brought considerable attention to the benefit increase provisions. Of particular concern was the fact that the CPI appeared to be overstating the rate of inflation because of the way it measured changes in the costs of homeowner-

ship (and thus resulted in excessive benefit increases). As a result, a number of proposals emerged in the 1981–83 period that called for constraints of one form or another on the automatic benefit increases.

Congress ultimately adopted two changes to the automatic increase provisions in 1983, among many measures to improve the financial condition of the system. Both had been recommended in January 1983 by the National Commission on Social Security Reform, a bipartisan panel appointed late in 1981 by the President and congressional leaders to work out a solution to social security's financial problems.

The first measure moved the effective date of future benefit increases from July to January. The change became effective in 1983, thereby delaying the July 1983 benefit increase to January of 1984. The result was an 18-month interval between the 1982 and 1984 benefit increases (from July 1982 to January 1984). The CPI measuring period also was changed from a first quarter to first quarter basis to a third quarter to third quarter basis. This too was effective in 1983, thereby causing the 2.5 percent rise in the CPI which occurred between the first and third quarters of 1983 to be permanently ignored in the determination of the 1984 and subsequent benefit increases. These changes produced both immediate and long-term savings for the system.

The second measure authorized a so-called "stabilizer" provision, which required that whenever the reserves of the social security trust funds (excluding medicare) were below certain levels, benefit increases would be limited to the rise in national wage levels if lower than the rise in the CPI. For increases payable in the 1985–89 period, the provision could be triggered if the system's reserves fell below a level equal to 15 percent of annual expenditures; for increases in 1990 and later years, the trigger level would equal 20 percent of annual expenditures. The measure further provided that if the stabilizer were triggered and caused a benefit increase to be lower than the rise in the CPI, a "catch up" increase could be given at a later time if and when the reserve of Federal securities held by the trust funds reached a level equal to 32 percent of annual expenditures.

These provisions were in both the House and Senate bills, H.R. 1900 and S. 1, the Social Security Act Amendments of 1983. The "stabilizer" provisions in the two bills were similar, following closely the recommendation of the National Commission on Social Security Reform: that the stabilizer be effective beginning in 1989 with a trigger level of reserves of 20 percent of annual expenditures. The Senate bill also included a so-called fail-safe provision, effective for benefit increases payable in 1986 and later, that would have required benefit increases to be scaled back whenever the system's reserves (including, in 1986 and 1987, those of the medicare hospital insurance program) were less than 20 percent of annual expenditures.[4] They were to be scaled back to the extent necessary

[4] A "fail safe" also had been recommended by the National Commission in principle, but the recommendation did not specify what form it should take.

to keep the system's reserve ratio from falling (taking into account the potential effect of the "stabilizer" and other provisions in the new law). Any such reduction was first to be imposed on those with benefit levels above $250 a month.

In conference the Senate fail-safe provision was dropped, and the stabilizer provision was modified to be effective earlier than specified in either of the House or Senate bills (i.e., in 1985 rather than 1989) with a lower trigger level for the 1985 to 1989 period (15 percent). The conference agreement was approved by both Houses on March 24, 1983, and was signed by President Reagan on April 20, 1983, becoming Public Law 98–21.

Legislation in 1984

Public Law 98–604

In July 1984 President Reagan proposed that the law be amended to assure that an automatic benefit increase be paid in January 1985 in the event inflation was so low that one would not otherwise be triggered. Under existing law automatic increases were authorized only after the cost of living rose by 3 percent. It appeared at that time that the CPI might rise by as little as 2.8 or 2.9 percent between the third quarter of 1983 and the third quarter of 1984 (the measuring period used for the January 1985 increase).

Amending a private relief bill passed by the House earlier, H.R. 1428, through an amendment by Senators Moynihan and Dole, the Senate quickly passed such a measure and sent it back to the House. It pertained only to the January 1985 benefit increase. The House passed a similar measure in October 1984, but through a different bill, H.R. 6299, reported by the Committee on Ways and Means. The House bill also included a provision requiring the social security actuaries to study the financial and technical effects of reducing the 3 percent trigger to 1 percent permanently and altering the CPI measuring period. The House bill was subsequently agreed to by the Senate and signed by President Reagan on October 30, 1984, becoming Public Law 98–604.

As it happened, the CPI rose by 3.5 percent during the measuring period, permitting an automatic increase of like amount to be paid in January 1985.

Table 1.—HISTORICAL COMPARISON OF BENEFIT INCREASES TO THE RISE IN THE CPI AND THE GROWTH OF WAGES

[In percent]

Date of increase [1]	Benefit increases		CPI (W) increases [2]		Wage increases [3]	
	Amount of increase	Cumulative (going back in time)	Between each increase	Cumulative (going back in time)	Year over year	Cumulative (going back in time)
January 1985	3.5	.....	[5] 3.6	.....	[5] 5.8	.....
January 1984	3.5	3.5	3.9	3.6	[5] 4.9	5.8
July 1982	7.4	7.1	6.9	7.7	5.5	10.2
July 1981	11.2	15.0	9.5	15.1	10.1	16.3
July 1980	14.3	27.9	14.2	26.1	9.0	28.0
July 1979	9.9	46.2	11.1	44.1	8.7	39.5
July 1978	6.5	60.7	7.4	60.0	7.9	51.7
July 1977	5.9	71.2	6.9	71.9	6.0	63.8
July 1976	6.4	81.3	5.9	83.7	6.9	73.6
July 1975	8.0	92.9	9.3	94.6	7.5	85.6
1974 [4]	11.0	108.3	16.4	112.7	12.6	99.5
October 1972	20.0	131.2	5.9	147.6	9.8	124.5
February 1971	10.0	177.4	5.2	162.2	5.0	146.6
February 1970	15.0	205.2	10.8	175.8	11.0	158.9
March 1968	13.0	250.9	9.3	205.5	19.6	187.5
February 1965	7.0	296.6	7.9	233.9	20.8	243.8
February 1959	7.0	324.3	8.0	260.0	22.2	315.4
October 1954	13.0	354.0	0.5	288.7	6.1	407.6
October 1952	12.5	413.1	9.3	290.6	16.9	438.7
October 1950	77.0	477.2	75.5	326.9	112.9	529.7
February 1940	.....	921.6	.....	649.4	.....	1,240.5

[1] Represents the month in which the benefit increase actually became payable. (Social security benefits are effective for the month before they are paid.) Except for those provided in 1950, 1952, and 1954, benefit increases typically were uniformly-applied and across-the-board increases.

[2] Represents the change in the CPI for periods ending the month before the actual payment date of each benefit increase.

[3] The year-over-year figures reflect the rise in average earnings levels from 1 year to the next. The "cumulative" figures represent the rise in average earnings levels for periods ending with the calendar year before the actual payment date of each increase. The figures for both columns were derived from the "wage-indexing series" used for social security benefit computation purposes, and additional data developed by the Office of the Actuary of the Social Security Administration for the period from 1940 to 1950.

[4] Increase was provided in two steps, with 7 percent paid in April 1974, and the remainder in July 1974.

[5] Estimated.